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RR RUEHCHI RUEHDT RUEHHM
DE RUEHJA #0854/01 0821009
ZNR UUUUU ZZH
R 231009Z MAR 07
FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC 4007
RUCPDO/DEPT OF COMMERCE WASHDC
RHMFIUU/DEPT OF ENERGY WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHDC
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUEHZA/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUEHKO/AMEMBASSY TOKYO 0425
RUEHBY/AMEMBASSY CANBERRA 0576
RUEHBJ/AMEMBASSY BEIJING 4008

UNCLAS SECTION 01 OF 04 JAKARTA 000854

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E.O. 12958: N/A
TAGS: [ENRG](#) [ECON](#) [EINV](#) [SENV](#) [PGOV](#) [ID](#)
SUBJECT: ENGAGING INDONESIA ON BIOFUELS POLICY

REF: 06 JAKARTA 9864 (Billions for Biofuels)

11. (U) This is an action request; see para 17.

12. (SBU) Summary. The Government of Indonesia (GOI) is continuing its ambitious 5 year, multi-billion dollar investment plan to boost biofuel production to 200,000 barrels per day by 2010. At a high-profile media event on January 9 the GOI signed 58 initial agreements reportedly worth \$12 billion with foreign and domestic biofuels investors. Chinese, Japanese, and Malaysian firms are the most active in announcing deals. The huge price tags attached to the public announcements mask the tentative status of many of the deals, however. Despite the land grab quality of some of these projects, the GOI has announced modest and sensible biofuel policies to date, including a \$108 million fund to create incentives for biofuels investments and \$1.08 billion to improve agricultural and rural infrastructure. Although Indonesia has a history of dramatic policy programs, many of which never come to fruition, the GOI's biofuel initiative appears to be here to stay. The U.S. Trade Development Agency has agreed to fund a 10-person GOI biofuels delegation to visit the United States in the near future, and we are currently coordinating trip details with the GOI. On March 23 the national biofuels team chief expressed enthusiasm for the TDA trip and said he hoped to combine the U.S. trip with a previously accepted invitation to travel to Brazil in May. The GOI is eager to learn from the U.S. experience, and we recommend Washington agencies meet with the GOI biofuels delegation in Washington for policy discussions, possibly under the auspices of our Bilateral Energy Dialogue. This report uses an exchange rate of Rp 9200. End summary

Billion Dollar Bandwagon; Deals Still Tentative

13. (U) On January 9, dozens of foreign and domestic companies signed agreements with the GOI to develop 58 biofuel projects. The GOI said the agreements totaled more than \$12 billion and will be key in supporting the GOI's plan to boost biofuel production to 200,000 barrels per day by 2010, reducing fossil fuel use by 10 percent. AlHilal Hamdi, chairman of the National Biofuels Development Team, told reporters that the projects under development will include biofuel crop plantations and processing plants. He said Indonesia plans to use crude palm oil (CPO), jatropha curcas, cassava, and sugar cane as feedstock. Local analysts tell us these projects have large price tags but are very far away from being done deals.

14. (U) Hamdi said that the GOI will make available 6.5 million hectares of land for biofuel crop development: three million hectares for oil palm, 1.5 million hectares for jatropha curcas, 500,000 hectares for sugarcane, and 1.5 million hectares for cassava. He added that the GOI estimated that investment per hectare will be as follows: Rp 30 million (\$3260) for oil palm, Rp 15 million (\$1630) for sugarcane, Rp 3 million (\$326) for jatropha curcas and Rp 3.5 million (\$380) for cassava. He noted that the GOI has ambitious rural employment objectives for the plan, as well, and had projected it will give jobs to three million Indonesians. The GOI said it is seeking to develop 11 biofuel processing plants to produce 187 million liters in 2008 and 1.3 billion liters by 2010, equivalent to the country's total fuel consumption of 41 million kiloliters in 2005. Its goal is to cut fossil fuel use in the transportation sector by 10 percent and by 50 percent in the electricity sector.

Chinese Looking For New Growth and Tech Transfer

15. (U) China National Offshore Oil Corp (CNOOC), China's dominant offshore oil and gas producer, made the biggest splash of the day with its signing of a memorandum of understanding with companies controlled by the Indonesian conglomerate the Sinar Mas Group to invest \$5.5 billion in biofuels. CNOOC may team up with Sinar Mas Agro Resources and Technology to develop biodiesel from crude palm oil and bioethanol from sugar cane or cassava in Papua and Kalimantan. According to a Sinar Mas press release, the three companies will develop the project in three phases and over eight years. Papua and Kalimantan regional governments have reserved approximately one million hectares of land (2.4 million acres) for the consortia. If the project comes to fruition, in terms of investment value it would roughly equal BP's \$5 billion Tangguh LNG

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project in Papua and supercede China's biggest overseas oil acquisition, the \$4.2 billion PetroKazakhstan acquisition in 2006.

16. (U) CNOOC officials told reporters that the project, if it goes forward, would open up a potential new growth avenue and give valuable experience to transfer back to China. Also during the event, the partners reportedly signed financing deals with state-owned banks Bank Mandiri and BNI, though they refused to release any details on financing arrangements. In fact, the partners disclosed few details of the deal at all and were careful not to call them contracts, stressing they were merely "like memoranda of understanding". The partners gave no project milestones nor did they say how the investment will be apportioned. CNOOC spokesmen emphasized that they will conduct feasibility studies at each stage of the venture before deciding whether to proceed to the next stage. Local industry analysts say that success in this project would help Sinar Mas Group begin to repair its reputation, which has been sullied by the massive bond default of its Asia Pulp and Paper unit.

GOI Biofuels Policies Sensible to Date

17. (U) In addition to the spate of biofuels projects described above and below, the GOI has also announced a trio of modest policy initiatives designed to promote biofuels development. On December 20, 2006 Finance Minister Sri Mulyani Indrawati signed memoranda of understanding (MOUs) with state-owned Bank Mandiri, Bank Rakyat Indonesia, Bank Bukopin, and two regional banks, to provide up to Rp 25.6 trillion (\$2.8 billion) to finance the development of biofuel feedstock crops and infrastructure. The banks will disburse the loans in stages over the next few years according to plantations' needs. Under the terms of the MOU, interest rates on loans to plantations will be capped at 10%, with the GOI subsidizing any further interest charges. The GOI pledged in its Fiscal Year 2007 budget to provide interest-rate subsidies of up to Rp 1 trillion (\$108 million) to support the program. The remainder of the money will go to rural areas to build biofuels processing plants and roads. In January the GOI issued a regulation granting tax incentives for Indonesian domestic investments in certain business sectors, including biofuels. The new regulation provides:

-- Accelerated depreciation of fixed assets at twice the rate under normal circumstances;

-- Tax loss carry-forward up to 10 years (instead of 5);

-- Investment tax credit reduction of net income by 30% of capital (land, buildings, equipment) invested to be pro-rated over six years, at 5% per year.

Malaysians May Pony Up \$4 Billion

¶8. (U) Malaysia's Genting, one of the country's leading corporations, also inked a plan to invest as much as \$3 billion for biofuels plants in Papua, according to local press. A Genting spokesman said they will invest via their Singapore-based Genting Biofuels Asia. Meanwhile, compatriot MultiVest Corp. announced a partnership with several Indonesian parties to build a \$1 billion biofuel production center in West Kalimantan, where the company already has 100,000 hectares of plantation land.

¶9. (U) Malaysia and Indonesia, which are the world's top palm oil producers, decided last year to allocate nearly 40 per cent of their crude palm oil output for biodiesel production. The move helped drive palm oil prices to \$560 per ton in January from around \$340 in January 2006, a 65% jump. The GOI has estimated the biodiesel industry will use 600,000 tons of crude palm oil this year. A leading trade publication editor forecast this month that Indonesia will produce 17.1 million tons of palm oil in 2007, surpassing Malaysia as the biggest supplier for the first time. Malaysia is targeting output of 16.5 million tons this year.

Local Companies Also Sign Deals

¶10. (U) Indonesian firms also announced new partnership agreements

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at the conference. PT Medco Etanol Indonesia, a subsidiary of national energy firm PT Medco Energi International, signed an agreement with state plantation firm PTPN VIII to develop cassava-based bioethanol projects in Garut and Cianjur, West Java. Coal mining firm PT Berau Coal signed agreements with Berau regency administration and the Ministry of Agriculture's Center of Plantation Research and Development to develop jatropha curcas projects. To develop jatropha curcas as a source of biofuel, Sinarmas will cooperate with the Bogor Institute of Agriculture and the Agriculture Ministry to establish a 500 hectares research center in Deltamas, Kerawang, West Java. Separately, State electricity company PLN signed an MOU during February with the International Finance Corporation for a feasibility study on the development of biofuel-based power plants.

¶11. (U) A spokesman for Singapore's Wilmar Energy subsidiary, PT Bukit Kapur Reksa (BKR), told reporters at the January signing conference that it is set to start operations in May 2007 for its biodiesel plant (see ref A). The facility, located in Dumai in Riau province, will have a capacity of one million liters of crude palm oil (CPO) per year.

JBIC Offers "Unlimited" Biofuels Loans

¶12. (U) The Japan Bank for International Cooperation (JBIC) said in February it is ready to fund GOI or private sector biofuel projects.

"The Japanese Prime Minister has instructed JBIC to extend loans for the development of bio-fuel. The amount of loans that JBIC will provide is unlimited," said JBIC's Toyoaki Fujita in Jakarta on February 6 at a biofuels conference. Fujita said JBIC would offer fixed-rate terms that undercut commercial rates currently on offer in Indonesia.

¶13. (U) Japan's Kanematsu Corp. is reportedly considering building a biofuel plant using cassava as a feedstock, according to Industry

Minister Fahmi Idris who spoke to reporters on January 19. He said Kanematsu was studying building a 100,000 liters per day-capacity bioethanol plant. Idris added that the company was also looking for 50,000 hectares (123,600 acres) of land to plant cassava for feedstock. Kanematsu has already broken ground on a 200,000 liter per day cassava-based bioethanol plant in Thailand, according to the company's website.

¶14. (U) Biofuels chief Hamdi told a local news agency on February 28 that Britain's BP planned to invest about \$50 million in a jatropha oil project with an annual capacity of 350,000 tons from 100,000 hectares of jatropha plantations. Hamdi claimed, also according to press reports, that Sweden Bioenergy planned a similar sized investment, also using jatropha. BP confirmed to press that it does have a similar-sized jatropha oil-based biofuel investment in India, but denied they have agreed to an Indonesian deal. BP said it still studying investment opportunities all over the world.

TDA Funds Biofuels Delegation to U.S.

¶15. (SBU) The U.S. Trade Development Agency has offered to fund approximately ten Indonesian delegates to visit the United States within the next six months. We are currently working with biofuels Chief Hamdi to determine the GOI's terms of reference for the visit.

On March 23 Hamdi told us that he was enthused by the idea of visiting the U.S. and hoped that he could combine our trip with a previously accepted invitation to travel to Brazil in May. The TDA has notionally scheduled visits to Minnesota, the only state that requires biodiesel use, to meet with biofuels producers and regulators and to Colorado to visit the DOE's National Renewable Energy Laboratory. We have invited Hamdi to lead the delegation and have tentatively penned in representatives from the Directorate General of Oil and Gas, Pertamina's downstream operations, the Indonesian Palm Oil Commission, as well local companies that will be building biofuels processing plants.

¶16. (U) USAID is also funding a biofuels pilot project in Flores. As part of its Agribusiness and Marketing Support Activity project (AMARTA) USAID is developing a 50 - 70 hectare pilot project to cultivate and process crude jatropha oil to partially meet the energy needs of remote fishing villages. USAID will offer grants to the villages as part of the three year project to fund purchase of

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plant materials, planting and maintenance, harvesting and post-harvesting equipment, and processing of crude jatropha oil. USAID is also paying for training, education, and demonstrations on uses of jatropha oil as a kerosene substitute, as well as developing a soap making cottage industry with the extracted glycerin byproduct.

¶17. (SBU) ACTION REQUEST: The GOI's biofuel development program is the Yudhoyono Administration's most prominent economic policy initiative at the current time, and Indonesia has the potential to be a very large player on world biofuels markets. The GOI does face large hurdles in meeting its program goals, but the GOI is eager to learn from the U.S. experience with biofuels. TDA has allotted several days for delegates to stop in Washington for policy discussions with USG agencies. We accordingly recommend that Washington agencies agree to receive the delegation for discussions on biofuels policy and possible avenues of further bilateral collaboration, possibly under the rubric of our Bilateral Energy dialogue. The GOI would be very interested in hearing USG views on biofuels policy implementation, including fiscally and environmentally sound biofuels subsidy and regulatory policies, promoting biofuels research and development, and policies that balance food-versus-fuel trade offs in an economically sustainable manner.

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